ICR Review

Operations Evaluation Department

Report Number : ICRR11800

1. Project Data:		Date Posted :	07/27/2004	
PROJ ID :	P063732		Appraisal	Actual
Project Name :	Indonesia Corporate Restructuring TA	Project Costs (US$M)	35	7.37
Country:	Indonesia	Loan/Credit (US$M)	31.5	5.82
Sector(s):	Board: PSD - General industry and trade sector (57%), Central government administration (38%), Law and justice (5%)	Cofinancing (US$M)	3.5	1.54
L/C Number:	L4448; LP357			
		Board Approval (FY)		99
Partners involved :	Government of Indonesia	Closing Date	06/30/2001	12/31/2003

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2. Project Objectives and Components

a. Objectives

Accelerate process of corporate restructuring :The project was designed to assist the Indonesian Government in accelerating the process of corporate restructuring . Corporate restructuring was deemed crucial to helping Indonesia resume private sector-led growth, preserve and expand employment, and increase living standards . It was expected that the Government's corporate restructuring program would help restore the ability of corporations to borrow and service debt and improve corporate governance . It was also expected that strengthening corporations would help support ongoing reforms in the banking and financial sectors .

Strengthen bankruptcy system and support legal reform : In part to create stronger incentives for firms to reach out-of-court restructuring agreements, the project also aimed to implement legal reforms, strengthen the bankruptcy system, and strengthen the Commercial Courts .

b. Components

The project components and estimated and actual expenditure were :

1. Facilitation and advisory activities to support corporate restructuring (US$17.2m, US$5.1m,)
2. Streamlining and strengthening regulatory, legal and administrative processes for corporate restructuring (US$5.1m, zero)
3. Training, operations and capacity building for the Jakarta Initiative Task Force (JITF) (US$3m, US$1.99m)
4. Coordination between JITF and other institutions, operations (US$2.5m, US$0.05m)
5. Implementation Support, Operations, and Capacity Building for Bank Indonesia, INDRA, Commercial Courts (US$3.5m, US$0.22m)

c. Comments on Project Cost, Financing and Dates

Factors reducing project cost included : retroactive financing allocation not used; local consultants and individual foreign consultants proved sufficiently capable, reducing the need for expensive international consulting firms; availability of TA from other sources; some institutional development TA was not needed because the intended beneficiary agencies were closed as a result of process streamlining; the Commercial Court component did not progress quickly enough to require expected funding . Due to a late start and limited progress achieved during the first year of project implementation, the project closing was postponed, and the project closed two and a half years later than envisioned.

3. Achievement of Relevant Objectives:

Accelerate process of corporate restructuring : JITF, the principal agency charged with accelerating voluntary corporate restructuring, achieved little progress during the project's first year (see discussion of quality at entry in section 5). However, by end-2003, JITF had participated in the mediation of more than 117 individual corporate debt restructuring cases with a total value of US$ 29.7 billion. Of these cases, 96 totalling US$20.6 billion had reached legal closure, with the balance having been negotiated but awaiting final signature . The project was also instrumental in reducing administrative and legal obstacles to out -of-court corporate restructuring, in part due to Government compliance with IMF conditionality .

Strengthen bankruptcy system and support legal reform : Little progress was made on legal reform, promoting a stronger bankruptcy process, or strengthening the Commercial Courts .

4. Significant Outcomes/Impacts:

- The project was effective in providing a voluntary forum within which debtors and creditors could reach agreement on corporate financial restructuring
- Around one third of the non-performing loans resulting from the financial crisis of 1997 were resolved through this mechanism
- The regulatory, legal, and administrative processes for corporate restructuring were streamlined, and a number of effective incentives were put into place that increased the propensity of firms to participate in the JITF process
- Institutional changes introduced by the project include establishing an alternative debt resolution process worked outside the court system; although JITF has been dissolved, the demonstration of its usefulness could be useful in the future. In addition, trained JITF staff have moved to a new mediation center, which fits in with the requirement that firms pass through this center prior to a court settlement .

5. Significant Shortcomings (including non-compliance with safeguard policies):

1. The quality of the some of the debt restructuring was not good, especially prior to 2002, as it consisted of extensions of grace periods or rescheduling debts . As a result, there was little operational restructuring and little improvement in corporate governance. The problem of the quality of restructuring was recognized in the June 2001, Mid-term Review, which noted "Despite good progress in terms of quantity, most of the restructuring of debt mediated through JITF has been through term extensions and debt-equity or debt asset conversions." The Mid-term Review urged greater attention to operational restructuring: "Indonesian corporations are undergoing very little fundamental restructuring and could emerge from the crisis largely intact and still very vulnerable ", but even toward the end of project implementation, the issue remained, as noted in the Eighth Report of the JITF (November 2002): "in many cases" the mismatch between ongoing debt and cash flow is "a product of inefficient operations or faulty business models." The expectation that debt/equity swaps or other forms of restructuring would bring about a change in ownership and a consequent improvement in corporate governance was not realized, as noted in the JITF Final Report (December 2003).

2. Efforts to improve the bankruptcy process and the legal system were unsuccessful. At the root of JITF's inability to bring about fundamental reforms in highly indebted corporations was the failure to make progress in strengthening bankruptcy protection and other legal reforms. The prospect of effective legal action would have been a significant incentive for firms to restructure their debt and would also have likely improved the quality of debt restructuring . The project component intended to streamline and strengthen regulatory, legal, and administrative processes for corporate restructuring was not implemented.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	One of the two objectives, strengthen bankruptcy system and support legal reform for corporate restructuring, was not achieved. The second objective, accelerating the process of corporate restructuring, was achieved.
Institutional Dev .:	Substantial	Modest	Institutional changes described under section 4 might have a lasting impact on the corporate sector. On the other hand, the bankruptcy process and the legal system were not substantially improved.
Sustainability :	Likely	Non-evaluable	The JITF was dissolved as intended. No information is currently available on the present status - in terms of sales, profitability, resumption of borrowing, etc.- of the firms that were financially restructured during the project, which would provide insight into the sustainability of the restructured firms.
Bank Performance :	Satisfactory	Unsatisfactory	Quality at Entry is rated as unsatisfactory by both QAG and the ICR. The project was prepared quickly, the initial institutional structure set up for restructuring was overly complex,

			Government commitment was initially lacking, and readiness for implementation was poor. Bank supervision was pro-active; it helped to streamline the project structure and get implementation moving, although it consistently rated development objectives as satisfactory throughout project implementation in spite of the fact that one of the two project objectives was never met. The pro-active supervision was not sufficient to overcome the handicaps imposed by initial design and ambition of the project.
Borrower Perf .:	Satisfactory	Satisfactory	On balance, Borrower performance is rated as satisfactory, as the Borrower followed the Bank's advice (after slow initial progress) and did largely what it was obligated to do under the project (except for the legal reform component).
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

- The Bank should not undertake a project without sufficient knowledge of the intended beneficiaries, in this case, the firms intended to be restructured, and their operational soundness
- Even in a situation perceived as urgent, the Bank needs to ensure that conditions critical to successful project launch and implementation are in place: institutional arrangements, Borrower commitment, design appropriate to achieve stated objectives
- Field-based supervision was critical to improving project performance, as the political and economic circumstances changed rapidly

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is satisfactory, but with the following shortcomings:

- The case for satisfactory outcome would have been stronger if the ICR had been able to present information on the subsequent performance of firms restructured by JITF, information which was being gathered after the ICR was written. In the absence of such evidence, the ratings are open to challenge on the grounds that the quality of the restructuring may not have been an adequate basis for future growth, investment, and borrowing .
- While the ICR acknowledges that the 1998 crisis exposed underlying needs for operational restructuring, the evaluation could have given more prominence to this aspect of restructuring; the ICR takes the view that operational restructuring was the responsibility of the parties themselves, beyond the mandate of JITF, but the need for and quality of operational restructuring are relevant to the sustainability of the outcomes .